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EB/IFD/OMA FOR AHAVILAND AND ASIROTIC
PASS NSC FOR JOSE CARDENAS
PASS FED BOARD OF GOVERNORS FOR PATRICE ROBITAILLE
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TREASURY FOR RALBANO AND LTRAN
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E.O. 12958: N/A
TAGS: EFIN ECON EINV AR
SUBJECT: IDB's ARGENTINA STRATEGY

REF: (A) Buenos Aires 540

(B) Buenos Aires 360
(C) Buenos Aires 311

Summary

¶1. (SBU) With $8 billion in approved credits, Argentina is the IDB's single largest creditor. IDB Argentine Country Director Daniel Oliveira told the Ambassador during a March 20 meeting that this Argentine portfolio concentration will likely increase in the short term given Argentina's temporarily restricted access to international capital markets, the ready access some of the IDB's sovereign borrowers now have to competitive funding in domestic and global capital markets, and competition the IDB is facing from alternative national and regional credit sources, including Brazil's BNDES and the CAF. While Oliveira appreciated the regional political dynamics that lead Venezuela to champion the creation of the Banco del Sur, he questioned whether dispersing resources and capitalizing yet another regional development bank is in the best interest of Latin nations.

¶2. (SBU) The IDB remains concerned about the viability of Argentina's heterodox and interventionalist economic policy mix. Oliveira predicted that if, in the next few years, Argentina modifies its macroeconomic and micro-pricing policies and settles with Paris Club creditors and bond holdouts, it will regain access to international capital markets and rely less on IDB credits. Given this, the IDB is modifying its 2004-2008 country strategy for Argentina to focus on assisting the GoA's Planning Ministry in building its own in-house planning capacity; structuring over $6 billion in sector-specific lines of credit to allow a more capable GoA more flexibility in IDB loan management; expanding support for

non-traditional science and technology lending; developing direct lending relationships with individual provinces; and expanding funding to the private sector. Notwithstanding approval to $1.8 billion in new loans to Argentina in 2007 and over $1.5 billion in 2006, the IDB is projecting a net neutral cash flow in the medium term. End Summary

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Argentina: Key IDB Client

¶3. (SBU) Following a March 7 meeting with Inter-American Development Bank (IDB)US Executive Director Hector Morales (Ref A), Ambassador met March 20 with IDB Argentina Country Director Daniel Oliveira to review current Bank operations in Argentina. Oliveira highlighted the growing importance of Argentina to the IDB: With roughly $8 billion of the IDB's total of $36.3 billion in active credits (including credits approved by the IDB Board but not yet disbursed), Argentina is the Bank's single largest creditor. He said this relative concentration would likely increase in the short term given Argentina's currently restricted access to international capital markets and the significant shift in borrowing dynamics of the IDB's traditional client base: Mexico, he said, has prepaid half of IDB outstandings by funding 30 year maturity paper in its internal markets; Brazil can borrow independently in domestic and international capital markets at competitive rates, and Chile has limited its IDB borrowing to select "boutique credits." In the 3-5 year term, Oliveira expects the dollar value of total IDB exposure to Argentina to decline slightly, as Argentina comes to terms with Paris Club and bond holdout creditors and regains more flexible access to international capital markets.

¶4. (SBU) Oliveira contrasted the IDB's active presence in Argentina with the significant decline in World Bank exposure here over the past four years. As a result, he said, while IDB credits have remained steady as a percentage of overall Argentine public debt (6.3% in 2006 vs. 6.1% in 2002), they have increased dramatically as a percentage of GoA debt with international organizations (55.7% in 2006 vs. 27.6% in 2002). (Note: This significant increase speaks both to a decline in World Bank outstandings and the GoA's 2005 paydown of over $9 billion in IMF obligations. End Note). He called the IDB Argentina's single largest credit window, with Chavez's Venezuela, which has facilitated the placement of $4.2 billion in GoA sovereign debt since 2006, the second largest.

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Competition from Other Regional Development Banks
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¶5. (SBU) The IDB is re-inventing itself to adapt to changing market dynamics faced by its core Latin borrowers, the ready direct access some sovereign borrowers now have to competitive funding in domestic and global capital markets, and to competition from other national and regional development banks. Brazilian development bank Banco Nacional de Desarrollo (BNDES)alone, he said, issued over $23 billion in credits in 2006 (including a $3 billion line of credit to Argentina), more than the World Bank and IDB in Latin America combined. Also the Andean Development Corporation (Corporacion Andina de Fomento - CAF) approved a significant $5 billion in new project credits in 2006. The CAF's single "A" rating (vs. the IDB's "AAA" rating) and smaller capital base ($2.93 billion subscribed, $1.6 billion paid-in vs. the IDB's $100 billion subscribed and $4.5 billion paid-in) means it has a significantly higher cost of funding than the IDB. However, Oliveira pointed out that the CAF is much faster and more flexible in its loan approvals than the IDB and its lack of a sitting board gives its professional staff greater autonomy in putting new credits on the books. (Note: At the March 17-20 Guatemala IDB annual meeting, local media reported that Economy Minster Miceli said that the GoA was considering increasing its capital contribution to CAF by $500 million in order to expand the volume of CAF infrastructure financing it can access. End Note).

¶6. (SBU) Oliveira noted reports of Argentine, Brazilian and Bolivian support for Venezuela's proposal to create a new regional development bank, the Banco del Sur (Refs B,C). While he appreciated the regional political dynamics that lead Venezuela to champion this concept, Oliveira questioned whether capitalizing yet

another regional development bank was in the best interest of Latin nations. He noted that Brazilian Finance Minster Palocci, in recent remarks, had offered only lukewarm support for Brazil's participation in the Banco del Sur, saying that Brazil should also strengthen existing regional institutions CAF and the Fondo para el Desarrolo de la Cuenca de la Plata (FONPLATA - members Brazil, Argentina, Paraguay, Uruguay and Bolivia). Oliveira called FONPLATA a dysfunctional organization with a small capital base (in the $450 million range) and no authority to borrow in international capital markets to leverage member country capital contributions. FONPLATA also has experienced legal problems at its Bolivian headquarters, Oliveira said, that have forced it to hold recent board meetings in Paraguay.

The IDB's Strategy in Argentina

¶7. (SBU) While Oliveira praised the GoA's determination to maintain a healthy primary fiscal surplus, he noted that the IDB remains concerned about the viability of Argentina's heterodox and interventionist economic policy mix. Nevertheless, he predicted that if (1) Argentina's macroeconomic and micro-pricing policies are modified to allow a "soft landing" transition to more sustainable levels of economic growth, and (2) Argentina comes to terms with Paris Club creditors and bond holdouts, then the country will regain ready access to international capital markets and traditional IDB major infrastructure project credits will likely diminish in relative importance.

¶8. (SBU) As a consequence, the IDB is re-examining its 2004-2008 country strategy for Argentina that initially envisioned $6-odd billion in new project approvals during this period with a focus on institutional strengthening, health, education, creation of a more favorable investment climate, and poverty reduction. New initiatives include:

-- Expanding the IDB's support of non-traditional science and technology lending. Oliveira said that the Bank had recently approved a $280 million technology modernization loan on these lines. (Note: In September 2006, the U.S. voted against a $50 million IDB loan to Argentina for the development of a satellite system, arguing that the financing of space programs an inappropriate use of MDB resources. End Note);

-- Assisting the GoA's Planning Ministry to develop its own in-house long term planning expertise. Oliveira noted a $2.5 million IDB technical assistance project in the works with the Planning Ministry, starting in the energy sector. To reward enhanced local planning capacity and to speed the disbursement process, Oliveira noted that the IDB is developing over $6 billion in sector-specific lines of credit in education, health, roads, water and sanitation projects that would allow the GoA more leeway in structuring loan drawdowns once it has demonstrated adequate performance to the IDB in that sector. Oliveira called the IDB's January 31 approval of a $350 million first tranche of a potential $1.5 billion credit line to finance lower and middle income housing development was the first trial of this credit line concept.

-- Developing direct lending relationships with individual provinces. While the federal government may regain significant access to international capital markets, Oliveira said, it is unlikely that any but the largest of Argentina's 24 provinces will be able to do so. The IDB has already established direct credits in the $50 - $100 million range to Salta, San Juan, Mendoza, Rio Negro, Cordoba, Buenos Aires and Entre Rios provinces, as well as to the City of Buenos Aires. These credits are not/not backed by a GoA sovereign guarantee.

-- Expand funding to private sector: While the IDB is authorized to allocate 10% of its country exposure to the private sector, at present under 5% of the IDB's lending in Argentina is non-sovereign. The Bank will more aggressively seek out direct lending opportunities. Ambassador noted that U.S. banks (Ref B) are eager to work with the IDB to help structure put together larger private

infrastructure development projects.

¶9. (SBU) So far in 2007, the IDB has approved three loans totaling almost $1.8 billion to Argentina, following the approval of over $1.5 billion in loans in 2006. Nevertheless, the IDB is projecting a net repayment of $142 million in 2007 and only a slight $212 million net credit outflow to Argentina in 2008.

Comment

¶10. (SBU) A long time Brazilian civil servant and former Brazilian Executive Director to the IDB, Oliveira is well schooled in development bank policy and his arguments for a shift in the IDB's approach to Argentina credits are well reasoned. He called the IDB a "stabilizing factor" in a potentially volatile Argentine economic cycle and asked for U.S. support for the Bank's efforts here. The IDB has arguably been more effective than the World Bank in gaining the GoA's confidence; some here argue that the World Bank has been unfairly tainted in the GoA's eyes by its historical Bretton Woods links to the IMF. Others argue that the World Bank has simply been more appropriately rigorous in its application of standard lending disciplines: Our IMF and World Bank contacts have been outspoken in their criticism of the IDB's reluctance to push for greater GoA transparency in MDB loan-linked government procurement. Oliveira argues that IDB programs are adhering to the same standards flowed by the World Bank.

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